Supreme Court, U.S.
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IN THE

Supreme Court of the United States

MAXIM PHARMACEUTICALS, INC.,
LARRY STAMBAUGH and KURT GEHLSEN,

Petitioners,

v.

CROSSPOINT VENTURE PARTNERS 1997, L.P., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF APPEAL OF CALIFORNIA,
FOURTH APPELLATE DISTRICT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The United States Court of Appeals for the Ninth Circuit follows a largely discredited Second Circuit opinion and holds that tort claims are subject to only the broadest contractual arbitration provisions, even if the contract in question does not evidence a specific intent to exclude such claims. A majority of other Circuits have come to a contrary conclusion. However, California courts are bound to follow the Ninth Circuit's construction when interpreting the Federal Arbitration Act. Based on this minority view, courts in the Ninth Circuit have refused to compel arbitration of fraudulent inducement claims. Therefore, the questions presented are:

1. Whether a judicially crafted exception to the well-established federal policy in favor of arbitration should be allowed to flourish and grow.

2. Whether an appellate court should review arbitrability, *de novo*, when an arbitration agreement requires disputes to be settled in accordance with the Commercial Rules of the American Arbitration Association and parties voluntarily submit to arbitration.

3. Whether fraudulent inducement claims relate to the performance or interpretation of a contract if the alleged misrepresentations would constitute a breach of the agreement.

PARTIES TO THE PROCEEDINGS BELOW

The following persons and entities were plaintiffs-appellants to the proceedings below and are Respondents to this petition, but their names have been omitted from the caption hereto for administrative convenience:

3I BIOSCIENCE INVESTMENT TRUST PLC, CROSSPOINT VENTURE PARTNERS 1997, L.P., SBIC PARTNERS II, L.P., DOMAIN PARTNERS III, L.P., DP III ASSOCIATES, L.P., DOMAIN PARTNERS IV, L.P., DP iV ASSOCIATES, L.P., SANDERLING VENTURES PARTNERS IV, L.P., SANDERLING IV LIMITED, L.P., SANDERLING IV BIOMEDICAL, L.P., SANDERLING [FERI TRUST] VENTURE PARTNERS IV, G.P., SANDERLING VENTURE PARTNERS IV CO-INVESTMENT FUND, L.P., SANDERLING VENTURE BIOMEDICAL PARTNERS CO-INVESTMENT FUND, L.P. (AKA SANDERLING IV BIOMEDICAL CO-INVESTMENT FUND, L.P.), SANDERLING IV VENTURE MANAGEMENT G.P., ECKARD WEBER, M.D., FRED MIDDLETON, F. RICHARD NICHOL, PH.D., RICHARD CANOTE, JEFF VICK, MARVIN E. ROSENTHALE, PH.D., LOWELL SEARS, PRASAD SUNKARA, PH.D. and ROBERT G. MCNEIL.

STATEMENT PURSUANT TO RULE 29.6

Petitioner Maxim Pharmaceuticals, Inc. ("Maxim" or "Petitioner") has no parent corporation and no publicly held company owns 10% or more of its stock. Petitioner is a publicly-traded corporation listed on NASDAQ.

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Maxim respectfully Petitions for a Writ of Certiorari to review the judgment of the Court of Appeal of California, Fourth Appellate District in this case.

OPINIONS BELOW

The Opinion of the Court of Appeal of California, Fourth Appellate District, reversing the decision of the superior court, is reported at 2004 Cal. App. Unpub. LEXIS 11186 (2004). (App. A, *infra*, 1a.) The Order of the Court of Appeal of California denying the Petitioners' petition for rehearing and request for publication is reported at 2005 Cal. App. LEXIS 29 (2005). The Order of the Supreme Court of California denying the Petitioners' petition for review is reported at 2005 Cal. LEXIS 2103. (App. D, *infra*, 45a.)

STATEMENT OF JURISDICTION

The judgment of the Court of Appeal of California, Fourth Appellate District was entered on December 10, 2004. (App. A, *infra*, 1a.) The Court of Appeal denied a timely petition for rehearing and request for publication on January 4, 2005. On February 23, 2005, the Supreme Court of California denied a petition for review. (App. D, *infra*, 45a.) Petitioners invoke the jurisdiction of this Court under 28 U.S.C. § 1257(a).

STATUTORY PROVISIONS INVOLVED

Federal Arbitration Act, 9 U.S.C.S. § 1, *et seq.*

STATEMENT OF THE CASE

I. FACTUAL BACKGROUND

Maxim is a publicly-traded corporation whose shares trade on the NASDAQ. This case stems from Maxim's acquisition of a privately-held, start-up drug company, Cytovia, Inc. ("Cytovia"). Maxim acquired Cytovia through a complicated transaction by which (1) Cytovia merged with a Maxim subsidiary, (2) Cytovia's shareholders received shares of Maxim's publicly-traded stock in exchange for their Cytovia shares, and (3) Cytovia became a wholly-owned subsidiary of Maxim. The transaction was consummated through a series of agreements, integrated into an Agreement and Plan of Merger ("Merger Agreement"). Respondents are venture capitalists who were Cytovia's directors, officers and principal shareholders. (App. A, 4a.)

The gravamen of Respondents' complaint is that they were allegedly induced to believe that Maxim's flagship drug was going to be approved by the United States Food & Drug Administration for national marketing. Respondents contend that Petitioners provided false information and withheld facts, in contravention of duties under the Merger Agreement to provide full and complete information. Respondents claim that they were therefore fraudulently induced to approve of and consummate the merger, and accept Maxim stock in exchange for their Cytovia shares. As it turned out, Maxim's drug was not approved and its stock — and, consequently, the value of Respondents' shares — plummeted.

The Merger Agreement includes an arbitration clause which requires arbitration of all disputes that "relate to the interpretation or performance of" the Merger Agreement.

(*See* App. E at 46a.) The arbitration provision further requires such arbitration to be held in accordance with the Commercial Rules of the American Arbitration Association. (*See* App. E at 46a.)

II. PROCEEDINGS BELOW

1. On October 19, 2001, Respondents brought suit in San Diego Superior Court asserting claims of fraud and negligent misrepresentation, alleging that they were fraudulently induced to (1) approve of and agree to the merger, and (2) exchange their Cytovia shares for stock in Maxim. In their Complaint, Respondents requested their attorneys' fees as permitted "by law and/or contract."

2. On November 28, 2001, Petitioners petitioned the trial court to compel arbitration under the Federal Arbitration Act, arguing that the FAA applies because the underlying transaction and parties involve interstate commerce.

3. The trial court issued a tentative ruling granting the petition to compel arbitration. Pursuant to local rules, Respondents were directed to identify with specificity any issues they wished to address at oral argument. (*See* App. C at 44a.) Respondents identified as the sole issue whether they, as non-signatories, could be compelled to arbitration. Respondents did not seek further argument on the federal law question regarding the scope of the applicable arbitration provision. After oral arguments, the trial court confirmed its tentative ruling and ordered the parties to arbitration. (*See* App. C at 42a-44a.)

4. Respondents sought immediate review of the order compelling arbitration by a Writ of Mandate. In their writ

petition, Respondents again argued that they, as non-signatories should not be compelled to arbitrate their claims. Respondents did not mention the scope of the arbitration provision. The Court of Appeal of the State of California, Fourth Appellate District declined to issue a writ, allowing the arbitration to go forward.

5. Respondents commenced an arbitration with the American Arbitration Association by filing a Demand for Arbitration. (*See* App. B at 26a.) In their Arbitration Demand, Respondents asserted claims of fraud and negligent misrepresentation. Respondents also asserted a new claim for breach of contract, alleging the Petitioners breached the Merger Agreement. (*See* App. B at 27a-28a.) This breach of contract claim was not compelled to arbitration by the trial court, as Respondents did not assert a breach of contract claim in their superior court case. (*See* App. A at 14a.) In their Arbitration Demand, Respondents sought recovery of their attorneys' fees. They also stipulated that the prevailing parties were entitled to their fees, as provided by the Merger Agreement. (*See* App. E at 47a.)

6. One of the Respondents, Robert McNeil, was not a party to the original trial court proceedings, but sought to intervene in the arbitration proceedings. The arbitrators granted McNeil's motion to intervene. (*See* App. B at 27a.)

7. After a full evidentiary hearing, a panel of three neutral arbitrators issued an interim decision, ruling against Respondents on all claims. In their interim decision, the arbitrators determined that Petitioners were entitled to their attorneys' fees. (*See* App. B at 26a-27a.)

8. Respondents sought reconsideration of the interim decision, arguing that the arbitrators did not have power to award attorneys' fees. (*See* App. B at 40a-41a.) The arbitrators denied Respondents' motion, and issued a final award granting Petitioners' attorneys' fees. (*See* App. B at 23a-24a.)

9. Petitioners petitioned the trial court to confirm the arbitral award and enter judgment thereon. Respondents opposed this motion and filed their own motion to vacate the award. Respondents claimed that the matter should not have been submitted to arbitration and that the arbitrators did not have the power to award attorneys' fees. The trial court entered judgment in favor of Petitioners, confirming the arbitral award. (*See* App. B at 18a-21a.)

10. On January 30, 2004, Respondents filed a Notice of Appeal to the California Court of Appeal — the same court that had denied the pre-arbitration interlocutory writ. In their appeal brief, Respondents argued that the trial court had erred in ordering non-parties to arbitration. Alternatively (and briefly) Respondents argued that the scope of the arbitration agreement did not encompass their fraudulent inducement claims. In this alternative argument, Respondents cited to the Ninth Circuit rule that arbitration clauses regarding the interpretation and performance of a contract are "intended to cover a much narrower scope of disputes." (citing *Mediterranean Enters., Inc. v. Ssangyong Corp.*, 708 F.2d 1458 (9th Cir. 1983) and *Britton v. Co-op Banking Group,* 4 F.3d 742 (9th Cir. 1993)). In opposition, Petitioners argued that the Federal Arbitration Act compelled affirmance of the judgment.

11. The California Court of Appeal applied a *de novo* standard in reviewing the judgment. (*See* App. A at 11a.) In an unpublished decision, the Court of Appeal held that the applicable arbitration provision was too "narrow" to encompass the claims at issue. (*See* App. A at 8a.) Petitioners had cited, *inter alia*, *Hall v. Internet Capital Group, Inc.*, 271 F. Supp. 2d 332, 335 (D. Me. 2003) for the strong federal policy in favor of arbitration and the proposition that doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. (*See* App. A at 14a-15a.) Although the appellate court "assume[ed] without deciding that the FAA applies," it found reliance on *Hall* to be "misplaced": "*Hall* is distinguishable in that it involved an arbitration clause that was broad in scope." (*See* App. A at 15a.) The court explained that (1) the arbitration clause in question was limited to disputes "relating to the interpretation or performance" of the agreement, and (2) the representations and omissions at issue commenced before the Merger Agreement was fully executed. (*See* App. A at 13a.) Therefore, it held, Respondents' fraudulent inducement claims were "plainly outside the scope of the arbitration clause." (*See* App. A at 15a.)

12. The California Court of Appeal further explained that "but for the error in compelling arbitration" against the other Respondents, McNeil would not have intervened. (*See* App. A at 16a-17a.) Therefore it reversed the judgment as to all Respondents, including McNeil. (*See* App. A at 17a.)

13. Petitioners filed a petition for rehearing and request for publication, which was denied by the Court of Appeal on January 4, 2005. On February 23, 2005, the California Supreme Court denied a petition for review. (*See* App. D at 45a.)

REASONS FOR GRANTING THE PETITION

In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), when interpreting the scope of a "broad" arbitration provision, this Court expressly recognized that fraudulent inducement claims should be resolved by an arbitrator when "there is no evidence that the contracting parties intended to hold that issue from arbitration." *Id.* at 396. This decision enforces the Court's strong policy favoring arbitration.

Acting contrary to this policy and precedent, The Second and Ninth Circuits have established their own rules governing the interpretation of the scope of arbitration provisions. *See In re Kinoshita*, 287 F.2d 951 (2d Cir. 1961) (fraudulent inducement claim held to be outside the scope of "narrow" arbitration provisions) *and Mediterranean Enters.*, 708 F.2d 1458 (following the Second Circuit rule of interpretation). According to these Circuits, the *Prima Paint* presumption of arbitrability does not apply to "narrow" arbitration provisions, effectively creating a rule that a fraud in the inducement claim can only be arbitrated when such claim is expressly *included* in the arbitration provision, or there is a "broad" clause.

This new interpretation rule, as well as the Second and Ninth Circuits' rejection of a policy favoring arbitration, put the Second and Ninth Circuits in direct conflict with Supreme Court precedent, the majority of the federal Circuit courts, and state courts construing federal law, all of whom have repeatedly determined that fraud in the inducement claims should be arbitrated – even when a "narrow" arbitration provision exists.

Even the Second Circuit seems to recognize the Circuit conflict created by its *Kinoshita* decision, and has limited the holding to its precise facts. In so doing, it has moved towards the majority of Circuit Courts. However, district courts in the Second Circuit are bound by *Kinoshita's* holding if they cannot distinguish a "narrow" arbitration clause. The Ninth Circuit now stands alone in its presumption *against* arbitrability under less than "broad" arbitration provisions.

This Petition presents a "compelling" opportunity for the Supreme Court to resolve this circuit court conflict and reinforce its fundamental policy favoring arbitration.

I. BOTH FEDERAL AND STATE COURTS MUST APPLY FEDERAL LAW WHEN DETERMINING THE SCOPE OF AN ARBITRATION PROVISION WHERE THE UNDERLYING TRANSACTION INVOLVES INTERSTATE COMMERCE

The Federal Arbitration Act applies to arbitration agreements if the underlying transaction "involves" interstate commerce, even if the parties did not contemplate that interstate commerce would be affected. *See, e.g., Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265, 281 (1995). In determining whether the transaction involves interstate commerce, courts should look at the parties' business operations. *See Ideal Unlimited Services Corp. v. Swift-Eckrich, Inc.*, 727 F. Supp. 75 (D. Puerto Rico 1989). Here, there can be no doubt that the Merger Agreement, as well as Maxim's operations and those of Respondents involved interstate commerce. Both Maxim and Cytoria were involved in drug development. Respondents contend that

Petitioners misrepresented that Maxim's flagship drug would be approved by the FDA. Respondents further contend that as a result of these misrepresentations they were induced to accept shares of Maxim's publicly-traded stock. Thus, the FAA applied.

The crux of the opinion below was that the applicable clause was not broad enough to encompass Respondents' claims. This determination hinges on federal law. In its opinion, the California Court of Appeal stated that it was "assuming without deciding" that the FAA applies. (*See* App. A at 15a.) The appellate court cited to and relied exclusively on federal cases interpreting the FAA. (*See* App. A at 14a-15a.) Indeed, there should have been no question that federal law controlled.[1]

"Federal law in the terms of the Arbitration Act governs [arbitrability of a dispute] in either state or federal court." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983); *see also Tracer Research Corp. v. National Environmental Services Co.*, 42 F.3d 1292, 1294 (9th Cir. 1994) ("the scope of the arbitration clause is governed by federal law."). *Bismarck v. Toltz, King, Duvall, Anderson & Associates, Inc.*, 767 F.2d 429, 431 (8th Cir. 1985) ("Determining what claims fall within the class of disputes

[1] If it had applied California law, the appellate court would have come to a contrary conclusion. California law is in line with non-Ninth Circuit precedent establishing that, unless expressly excluded, fraudulent inducement claims are subject to more-narrow arbitration provisions. *See Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street*, 35 Cal.3d 312, 323 (1983) (clause requiring arbitration of disputes "with respect to the provisions of" the contract, while not the broadest, nonetheless encompasses a fraud in the inducement claim).

governed by an arbitration agreement is a question of federal law."); *Hart v. Orion Ins. Co.*, 453 F.2d 1358, 1361 (10th Cir. 1971) ("The validity and interpretation of arbitration clauses affecting interstate commerce are governed by federal law.").

Not only does federal law apply in this case, there are no adequate and independent state law grounds for the Court of Appeal's decision. While Respondents had argued that they, as non-signators to the Merger Agreement, could not be bound to arbitrate their claims, that argument did not provide a basis for the Court of Appeal's decision. Nor could it. Although this question is arguably a matter of state law, the Court of Appeal assumed that Respondents could be bound. (*See* App. A at 10a-11a.) This was the correct conclusion under California law.[2] *See, e.g.*, *NORCAL Mutual Ins. Co. v. Newton*, 84 Cal. App. 4th 64 (2000) (nonsignator bound under estoppel theory); *Mormile v. Sinclair*, 21 Cal. App. 4th 1508, 1511 (1994) (nonsignator bound by arbitration agreement); *Harris v. Superior Court*, 188 Cal. App. 3d 475, 479 (1986) (same).

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[2] In an entirely different context, this Court recently stated, in *dicta*, that "a contract cannot bind a nonparty." *Equal Employment Opportunity Commission v. Waffle House*, 534 U.S. 279, 294 (2002). The Court found that the EEOC's remedies were not limited simply because an employee on whose behalf it was litigating had signed an arbitration agreement. Nothing in *Waffle House* affects the analysis here. Indeed, since *Waffle House*, courts have continued to recognize that nonsignatories may be bound to arbitrate. *E.g.*, *Restoration Pres. Masonry, Inc. v. Grove Europe Ltd.*, 325 F.3d 54, 63 n.2 (1st Cir. 2003) (explaining that *Waffle House* stated only a general principle; non-signatories "may be bound by or acquire rights under an arbitration agreement under ordinary state-law principles of agency or contract"); *Metalclad Corp. v. Ventana Environmental Org. Partnership*, 109 Cal. App. 4th 1705, 1717 (2003) (nonsignatory plaintiff estopped from avoiding arbitration provision).

II. THE NINTH CIRCUIT HAS ESTABLISHED AN EXCEPTION TO THE PRESUMPTION IN FAVOR OF ARBITRATION, REFUSING TO COMPEL ARBITRATION IN THE ABSENCE OF A CLEAR INTENT TO EXCLUDE CLAIMS

It has been almost forty years since this Court answered the question whether arbitrators or courts should resolve a claim that a contract (as opposed to an arbitration provision) was fraudulently induced. *See Prima Paint*, 388 U.S. 395. "[W]here there is no evidence that the contracting parties intended to withhold that issue from arbitration," the issue is within an arbitrator's purview. *Id.* at 396. The Court explained that in so holding, "we not only honor the plain meaning of the statute but also the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Id.* at 404.

In reaching its holding in *Prima Paint*, the Court noted that the arbitration provision before it was "broad," as it required arbitration of any claim or controversy "arising out of or relating to" the agreement or the breach thereof. *Id.* at 398.

The Second Circuit and then the Ninth Circuit latched onto the word "broad," finding the holding of *Prima Paint* inapplicable to more "narrow" arbitration agreements. As stated by the Second Circuit, a provision that requires arbitration of disputes "arising under" a contract is limited to controversies related to interpretation and performance of the contract. *In re Kinoshita*, 287 F.2d 951. Such a provision does not require arbitration of a fraudulent inducement claim. *Id.*

The Second Circuit rule has been adopted by the Ninth Circuit. *See Mediterranean Enters.*, 708 F.2d at 1463. The Ninth Circuit stated that "arising hereunder" is synonymous with "arising under" (the phrase in *Kinoshita*) and is restricted to matters relating to the interpretation and performance of the agreement. *Id.* at 1464. Several years later, the Ninth Circuit reiterated this rule, finding the phrase "arising out of" to have the same limited scope as the phrase in *Mediterranean. Tracer*, 42 F.3d at 1295. As a result, the Ninth Circuit explained, even if a tort claim would have not arisen "but for" the contract does not mean such claim is arbitrable. *Id.* at 1295. Under the "narrow" phrase, if a tort claim does not depend on an interpretation of the contact, it is not arbitrable. *Id.*

Under the Second Circuit rule, courts must follow a two-step procedure to determine whether a specific dispute is arbitrable. Courts must (1) examine the arbitration clause's language and classify the clause as either broad or narrow; and (2) determine whether the issue or dispute in question is collateral or non-collateral to the underlying agreement. *Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading Inc.*, 252 F.3d 218, 224 (2d Cir. 2001), *citing Mehler v. Terminix Int'l Co.*, 205 F.3d 44, 49 (2d Cir. 2000) If the arbitration clause is narrow, the court will not order arbitration for "collateral" matters. *Id.*

Although the procedural steps are not as clearly enunciated, the Ninth Circuit has adopted the Second Circuit rule. *See Mediterranean Enters.*, 708 F.2d at 1463. In another context, the California Court of Appeal, Fourth Appellate District explained (a month after authoring the underlying opinion here) that the Ninth Circuit's rule means a more narrow provision "encompasses only those actions directly

involving the application of [the subject contract] in specific factual contexts addressed by the [subject contract]." *MHC Financing Ltd. Partnership Two v. City of Santee*, 125 Cal. App. 4th 1372, 1398 (2005).

Here, the California Court of Appeal cited to *Mediterranean* and explained that the policies and presumptions in favor of arbitration were inapplicable because the arbitration clause was "narrow." (*See* App. A at 10a.) The appellate court therefore held that a fraudulent inducement of contract claim — the same type of claim at issue in *Prima Paint* — should not have been arbitrated.

In contrast to the Second and Ninth Circuits (and the California Court of Appeal), federal courts in the Fourth, Fifth, Sixth, Seventh, and Eleventh Circuits (as well as state courts construing federal law) have compelled arbitration of fraudulent inducement claims under similar, narrowly-worded arbitration provisions.[3] These courts have held that

[3] Fraudulent inducement-type claims have been compelled under provisions with the following "narrow" language: "arising out of," *Highlands Wellmont Health Network, Inc. v. John Deere Health Plan, Inc.*, 350 F.3d 568, 578 (6th Cir. 2003); "with respect to any amount," *Wellborn Clinic v. Medquist, Inc.*, 301 F.3d 634, 640 (7th Cir. 2002); "which may arise hereunder," *Gregory v. Electro-Mech. Corp.*, 83 F.3d 382, 383-85 (11th Cir. 1996); "relating to a breach of this agreement," *Matthews v. Rollins Hudig Hall Co.*, 72 F.3d 50, 54 (7th Cir. 1995); "arising out of," *Sweet Dreams Unlimited, Inc. v. Dial-A-Mattress Int'l, Ltd.*, 1 F.3d 639, 643 (7th Cir. 1993); "believed to constitute a breach or violation," *Peoples Sec. Life Ins. Co. v. Monumental Life Ins. Co.*, 867 F.2d 809, 813-14 (4th Cir. 1989); "with respect to the interpretation or performance," *Mar-Len of Louisiana, Inc. v. Parsons-Gilbane*, 773 F.2d 633, 636 (5th Cir. 1985); "with respect to the interpretation of this Agreement or the performance of

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because there is a federal policy in favor of arbitration, claims of fraudulent inducement should be excluded from arbitration only where the parties expressed an intent to exclude them.

For example, the Seventh Circuit has held that fraudulent inducement claims are arbitrable under a provision that

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the respective obligations of the parties," *Schacht v. Beacon Ins. Co.*, 742 F.2d 386, 391 (7th Cir. 1984); "under," *PNI, Inc. v. Leyton*, No. 03-1344-MO, 2004 U.S. Dist. LEXIS 13335, *16 (D. Or. 2004); "that may arise between" the parties, *Coffer v. Service Asset Mgmt. Co.*, No. 02 Civ. 9934 (DC), 2003 U.S. Dist. LEXIS 19676, *10 (S.D.N.Y. 2003); "arising under or in connection with," *Thies v. Lifeminders, Inc.*, No. 02-2119 KHV, 2002 U.S. Dist. LEXIS 22284, *29-30 (D. Kan. 2002); "under," *Prescott-Follett & Assoc., Inc. v. Delasa*, No. 01-3178, Section I/2, 2002 U.S. Dist. LEXIS 21988, *11 (E.D. La. 2002); "arising out of," *Weiss v. Travex Corp.*, No. 02 Civ. 2380 (SAS), 2002 U.S. Dist. LEXIS 12782, *9 (S.D.N.Y. 2002); "arising out of this transaction," *Automated Tech. Mach., Inc. v. Diebold, Inc.*, No. 01-2777, Section "C" (2), 2002 U.S. Dist. LEXIS 9146, *15 (E.D. La. 2002); "as to interpretation of," *RCM Tech., Inc. v. Brignik Tech. Inc.*, 137 F. Supp. 2d 550, 555 (N.J. 2001); "under the terms of," *Goldberg v. Focus Affiliates, Inc.*, 152 F. Supp. 2d 978, 982 (N.D. Ill. 2001); "concerning the interpretation or performance of any provision," *Integrated Health Serv., Inc. v. Kirschenbaum*, No. 95 C 7233, 1996 U.S. Dist. LEXIS 3165, *17-18 (N.D. Ill. 1996); "involving questions of interpretation of," *Hannah Furniture Co. v. Workbench, Inc.*, 561 F. Supp. 1243, 1244-45 (W.D. Pa. 1983); "arising out of" the agreement or "arising out of the interpretation or application," *Information Sciences, Inc. v. Mohawk Data Science Corp.*, 403 N.Y.S.2d 730, 732 (1978); "arising out of," *Griffin v. Semperit of America, Inc.*, 414 F. Supp. 1384, 1391 (S.D. Tex. 1976); "the effect or interpretation of any terms or provisions," *J.P. Stevens & Co., Inc. v. Harrell Int'l, Inc.*, 299 So. 2d 69, 70 (Fla. 1st DCA 1974) "arising out of," *Birmingham News Co. v. Lynch*, 797 So. 2d 440, 444 (Ala. 2001); "arising hereunder," *Aerojet-Gen. Corp. v. Non-Ferrous Metal Refining, Ltd.*, 322 N.Y.S.2d 33, 532 (N.Y. 1971).

requires arbitration of disputes "with respect to the interpretation of this Agreement or the performance of the respective obligations of the parties under this Agreement." *Schacht v. Beacon Ins. Co.*, 742 F.2d 386, 390-391 (7th Cir. 1984). The Seventh Circuit reiterated the "strong federal policy in favor of arbitration" and said an order to arbitrate a particular grievance "should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage." *Id.* (quoting *United Steelworkers v. Gulf Navigation Co.*, 363 U.S. 574, 582-83 (1960)); *see also Thies v. Lifeminders, Inc.*, No. 02-2119–KHV, 2002 U.S. Dist. LEXIS 22284, *31 (D. Kan. 2002) (fraudulent inducement claims arose "under or in connection with" a merger agreement and were therefore arbitrable).

In fact, the Second Circuit itself, which originated the rule followed by the Ninth Circuit, has seemed to back away from it. Since *Kinoshita* was decided in 1961, the Second Circuit has consistently distinguished cases in which variants of the "arising under" language were at issue and that court has permitted arbitration of fraudulent inducement claims. *See Ace Capital Re Overseas Ltd. v. Cent. United Life Ins. Co.*, 307 F.3d 24, 26 (2d Cir. 2002) ("any dispute **shall arise between** the parties hereto **with reference to the interpretation**" of the agreement) (emphasis added); *Genesco, Inc. v. T. Kakiuchi & Co., Ltd.*, 815 F.2d 840, 854-55 (2d Cir. 1987) ("all claims and disputes **of whatever nature arising under** this contract") (emphasis added); *S.A. Mineracao Da Trindade-Samitri v. Utah Int'l, Inc.*, 745 F.2d 190, 192-94 (2d Cir. 1984) (any dispute that "**shall arise or occur under**" the contract) (emphasis added).

The Second Circuit has repeatedly limited *Kinoshita*'s holding to its *precise* facts, although it has declined to overturn it. *See Genesco, Inc.*, 815 F.2d at 854 n.6; *S.A. Mineracao Da Trindade-Samitri*, 745 F.2d at 194; *see also Battaglia v. McKendry*, 233 F.3d 720, 725-27 (3d Cir. 2000) (although decided under Pennsylvania law, the court thoroughly analyzed *Kinoshita* and its progeny and found the rule stated by the Second and Ninth Circuits to be out of step with federal policy favoring arbitration). Indeed, since *Kinoshita* was published, the Second Circuit has never applied its holding and excluded a fraudulent inducement claim from a more narrow arbitration clause. However, because the Second Circuit has not overturned *Kinoshita,* district courts in the Second Circuit remain constrained to follow it. *See Bristol-Myers Squibb Co. v. SR Int'l Business Ins. Co.*, 354 F. Supp. 2d 499 (S.D.N.Y. 2005) (refusing to compel arbitration, stating that although *Kinoshita* is "out of step with the overwhelming body of law favoring arbitration," *Kinoshita* remains binding because the Second Circuit has refused to overrule it).

Similarly, *Mediterranean* and *Tracer* remain the law in the Ninth Circuit, leaving courts to distinguish what facially appear to be very similar arbitration provisions. *See Simula, Inc. v. Autoliv, Inc.*, 175 F.3d 716 (9th Cir. 1999) (distinguishing provision which required arbitration of disputes "arising in connection with this agreement" and compelling tort claim); *Metalmark N.W., L.L.C. v. Stewart*, No. 04-682-K1, 2004 U.S. Dist. LEXIS 18258 (D. Or. 2004) (finding "concerning" to be broader than "arising under"); *Chloe Z Fishing Co., Inc. v. Odyssey Re Ltd.*, 109 F. Supp. 2d 1236 (S.D. Cal. 2000) ("concerning any claim under," or "arising out of or in connection with" is broader than in

Mediterranean); *McMillin Dev., Inc. v. Builders Structural Services, Inc.*, No. 96-3458J (LSP), 1997 U.S. Dist. LEXIS 6809 (S.D. Cal. 1997) (factually distinguishing *Mediterranean* where provision required arbitration of disputes "that arise between" the parties "as to satisfactory compliance with [the contract] or construction standards"); *Prograph Int'l Inc. v. Barhydt*, 928 F. Supp. 983 (N.D. Cal. 1996) (fraudulent inducement claim compelled under provision which required arbitration of any dispute "in connection with" the agreement).

As with the Second Circuit, the Ninth Circuit has not seen fit to overturn *Mediterranean* and *Tracer*. A court in the Ninth Circuit is therefore constrained to make a seemingly conclusory distinction between "narrow" clauses (such as those at issue in *Mediterranean* and *Tracer*) and "broad" clauses. If the court is unable to distinguish a clause from a "narrow" one, the Ninth Circuit's holdings apply and arbitration will be refused except as to contract claims.

This Court has previously stated that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration and "any doubt concerning the scope if arbitrable issues should be resolved in favor of arbitration. . . ." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 650 (1986) (finding the presumption in favor of arbitration "particularly applicable" where the clause is broad);[4] *Mitsubishi Motors Corp.*

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[4] The clause at issue in *AT&T Technologies* required arbitration of differences "arising with respect to the interpretation of this contract or the performance of any obligation hereunder. . . ." 475 U.S. at 650. The Court stated, in *dicta*, that this clause was broad. It is, however, indistinguishable from the Ninth Circuit's definition of a "narrow" provision.

v. Soler Chrysler-Plymouth, 473 U.S. 614, 628 (1985) ("it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act.") The Ninth Circuit and Second Circuit add a threshold requirement before applying this policy. Under this minority view, courts have to determine a gateway issue: is the policy at issue broad or narrow? Only when a court determines it is construing a broad provision is it required to resolve all doubts in favor of arbitration.

Prior dictates of this Court have made clear the presumption in favor of arbitration means that arbitration should be compelled unless claims are clearly outside the scope of an applicable provision. Said another way, unless parties have expressed an intent to exclude claims, arbitration should be compelled. The Ninth Circuit and Second Circuit have reversed this presumption, based on the use of the word "broad" in prior Supreme Court cases. While the majority of Circuits disagree, there is certainly some doubt; doubt that has powerful impact on arbitration.[5] This Court should resolve this split and explicitly state that unless expressly excluded fraudulent inducement must be compelled under contractual arbitration provisions.

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[5] In this case, Petitioners incurred over a million dollars in attorneys fees in the arbitration. (*See* App. B at 18a-21a). Respondents likely invested a similar amount. Both sides — and three neutral arbitrators — invested substantial time in arbitrating these claims. The arbitrators then spent additional time adjudicating the claims.

III. WHETHER A MATTER IS ARBITRABLE IS NOT FOR THE COURTS TO DECIDE IF THE APPLICABLE ARBITRATION AGREEMENT INCORPORATES RULES WHICH ALLOW THE ARBITRATORS TO MAKE THIS DETERMINATION AND PARTIES VOLUNTARILY SUBMIT TO ARBITRATION

Under the Federal Arbitration Act, there is a general presumption that the issue of arbitrability — whether a particular matter is encompassed by an arbitration provision — should be resolved by the courts. *See, e.g., First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944-45 (1995). Indeed, whether an arbitration provision applies to a particular controversy is a "gateway" or threshold issue for the court to decide. *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 452 (2003) (contrasting the gateway issue to a question of what kind of arbitration the parties had agreed to, which is not a gateway issue for the courts); *Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 84 (2002) (while a disagreement about whether an arbitration clause applies to a particular type of controversy is for the court, determining how the applicable arbitration rules should be applied is the abitrators' domain); *AT&T Technologies*, 475 U.S. at 656 (the question of arbitrability is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise). However, where the parties have "clearly and unmistakably" provided that the question of arbitrability should be decided by the arbitrator, then the matter should be sent to arbitration. *See Howsam*, 537 U.S. at 83 (quoting *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. at 649).

Here, there was clear and unmistakable evidence that the question of arbitrability was to be decided by the arbitrators. The Commercial Arbitration Rules of the American Arbitration Association provide that the arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement. *See Contec Corp. v. Remote Solution Co., Ltd.*, 398 F.3d 205, 208 (2d Cir. 2005). The applicable arbitration provision incorporated Commercial Arbitration Rules of the American Arbitration Association. (*See* App. E at 46a.) "[W]hen, as here, parties explicitly incorporate rules that empower an arbitrator to decide issues of arbitrability, the incorporation serves as clear and unmistakable evidence of the parties' intent to delegate such issues to an arbitrator." *Contec Corp.*, 398 F.3d at 208 (holding that arbitration was the proper forum for determining whether a valid arbitration agreement exists).[6]

Moreover, one of the Respondents, McNeil, voluntarily submitted to the arbitration. (*See* App. B at 27a.) McNeil then argued, along with the other Respondents, that he could not be compelled to pay Respondents' attorneys' fees because he was not a party to the Merger Agreement. (*See* App. B at 40a-41a.) In other words, McNeil voluntarily came to the arbitration and asked the arbitrators to determine arbitrability.[7] The arbitrators

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[6] There is a Circuit spilt on this issue. *See Contec Corp.*, 398 F.3d at 210-211 (comparing *Shaw Group Inc. v. Triplefine Int'l Corp.*, 322 F. 3d 115, 120 (2d Cir. 2003) and *Apollo Computer v. Berg*, 886 F.2d 469 (1st Cir. 1989) with *Microchip Tech. Inc. v. U.S. Philips Corp.*, 367 F.3d 1350 (Fed Cir. 2004)).

[7] The other Respondents also asked the arbitrators to determine arbitrability by challenging the arbitrators' authority to award attorneys' fees. However, only McNeil's intervention was addressed on appeal.

determined that McNeil was a proper party to the arbitration who could be compelled to pay attorneys' fees. (*See* App. B at 27a, 40a-41a.) This finding is not reviewable on appeal. *See PowerAgent, Inc. v. Elec. Data Sys. Corp.*, 358 F.3d 1187, 1191 (9th Cir. 2004) (after requesting an arbitral decision on arbitrability, plaintiff "is now bound by the arbitration panel's findings on arbitrability and the merits unless it can overcome the *highly deferential* standard of review employed by the federal courts regarding arbitrator's holdings"); *see also Baer v. Terminix*, 975 F. Supp. 1272, 1279 (D. Kan. 1997) ("a party that agrees to submit the question of arbitrability to the arbitrator waives any right to later object to the arbitrator's authority" to rule on the question); *see also Colon v. Federal Reserve Bank*, 538 F. Supp. 498, 501 (N.D. Cal. 1982) ("A claimant may not voluntarily submit the issue to arbitration, await the outcome, and, if the decision is unfavorable, then challenge the authority of the arbitrators to act."); *see also Delaney v. Continental Airlines*, No. SACV 92-762-GLT, 1993 U.S. Dist. LEXIS 9868, *12 (C.D. Cal. 1993) (rejecting plaintiff's claim that he was not bound to arbitrate his dispute because he appeared and presented his case in arbitration).

The California Court of Appeal did not apply a deferential standard to the arbitrators' decision concerning McNeil. Instead, the appellate court applied its independent judgment. (*See* App. A at 11a.) The court mentioned that McNeil voluntarily intervened (over Petitioners' objections). It ignored, however the federal cases holding that by voluntarily entering the arbitration, McNeil was bound by the arbitrators' findings. Instead, the Court of Appeal simply distinguished a state case, explaining that because "there was no 'mandatory' arbitration procedure," McNeil's intervention had no impact. (*See* App. A at 16a-17a.)

Where, as here, parties voluntarily submit to arbitration under the Commercial Arbitration Rules of the American Arbitration Agreement, they should not be allowed to challenge the arbitrators' findings by appeal to the courts.

IV. FRAUDULENT INDUCEMENT CLAIMS RELATE TO INTERPRETATION OR PERFORMANCE OF AN AGREEMENT IF THE ALLEGED MISREPRESENTATIONS WOULD CONSTITUTE A BREACH OF THE AGREEMENT

Even if the Court were to find that the type of arbitration provision at issue here was more narrow than the provision in *Prima Paint*, Respondents' claims that they had been fraudulently induced to enter into and approve of the Merger Agreement were properly arbitrable.

The arbitration provision at issue here requires arbitration of all disputes that "relate to the interpretation or performance of" the Merger Agreement. (*See* App. E at 46a.) The Court of Appeal concluded that because some of the defendants' misrepresentations commenced prior to the execution of the agreement containing the arbitration provision, plaintiffs' fraud claims did not relate to performance of the contract and were not arbitrable. (*See* App. A at 13a-14a.) The Court of Appeal focused entirely on the word "performance," totally ignoring the phrase "relate to." The Court of Appeal also overlooked the fact that "performance" is not complete at the moment it commences.

Under the appellate court's reasoning, only breach of contract claims would have been arbitrable. This eviscerates the arbitration clause because after the merger was completed Cytovia ceased to exist except as a wholly-owned subsidiary

of Maxim. Therefore, the only disputes for which Cytovia could have sought arbitration would have been pre-merger representations or omissions — exactly those claims which the appellate court found to be outside the scope of the arbitration provision.

Moreover, while some of the alleged wrongful acts took place before execution of the Merger Agreement, others clearly did not. Under the Merger Agreement, Maxim had a continuing obligation to ensure that its representations were accurate and did not contain any material omissions. Indeed, Cytovia could have terminated the merger if any of Maxim's representations became inaccurate after execution of the Merger Agreement. Finally, these representations and warranty obligations survived for a year after the merger.

If Respondents' allegations were true, Petitioners would have breached contractual duties. In other words, Respondents claim they were injured by Petitioners' performance under the Merger Agreement.

Further, the record shows that Respondents' counsel conceded before the trial court that "had there been a breach of a representation and warranty prior to the closing [of the merger transaction] and there was a dispute about it, that issue would go to arbitration." This admission exposes the illogic of the Court of Appeal's conclusion that Respondents' claims are "plainly" outside the scope of the arbitration clause. At the very least, this raised a doubt whether Respondents' claims were arbitrable. This doubt should have been resolved in favor of arbitration.

V. THIS ISSUE IS ONE OF GREAT IMPORTANCE, TRANSCENDING THE DISPUTE BETWEEN THE PARTIES

In enacting the Federal Arbitration Act, surely Congress intended uniform application of the law. However, in interpreting *Prima Paint* and its progeny, Circuit courts have created a non-uniform body of law that provides no guidance to future courts and litigants. The Ninth Circuit and Second Circuit have extracted one word out of this Court's numerous decisions reiterating the policy in favor of arbitration. These courts have used this word, "broad," to create an exception to this policy.

Under the Ninth Circuit and Second Circuit rule, as adopted by the California Court of Appeal, "narrow" arbitration clauses are read restrictively, reversing the presumption in favor of arbitration. As demonstrated by the numerous cases in which courts go to great length to distinguish near identical language, even this rule is applied in a haphazard and unpredictable manner.

The ever-expanding loophole created by the Second Circuit and embraced by the Ninth Circuit should be closed. Otherwise parties will continue to contract for arbitration, expecting that their disputes will be arbitrated; courts will continue to compel arbitration; fees will be incurred and time invested, only to have the whole process erased because an appellate court decides, *de novo* and after the fact, that an arbitration provision was "narrow." It is hard to imagine a scenario that more clearly flies in the face of the federal policy in favor of arbitration.

CONCLUSION

This Court has frequently stated the strong federal policy in favor of arbitration and a presumption of arbitrability. However, the Second and Ninth Circuits reversed this presumption for "narrow" arbitration provisions. The uneven application of this exception flies in the face of the policies stated by this Court. It is time to stop this rule from spreading even further, and provide uniform guidance to courts and unsuspecting litigants.

Petitioners respectfully request that the members of this Court grant their Petition for a Writ of Certiorari.

Respectfully submitted,

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